

Message Text

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15

ACTION EB-07

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TAGS: EFIN, KS

SUBJECT: KOREAN DEFENSE TAX

REF: STATE 44437, SEOUL 1432

1. IN CONTEXT OF DISCUSSION FEBRUARY 27 ON THE SCHEDULING OF THE SIGNING OF THE BILATERAL U.S. ROK TAX CONVENTION, EMBOFF ADVISED LEE CHANG-CHOON (R/S SPELLING -YI CHANG-CH'UN), THE HEAD OF THE TREATY DIVISION OF MINISTRY OF FOREIGN AFFAIRS (MOFA), THAT AN IMPORTANT SUBSTANTIVE QUESTION HAD ARISEN AS RESULT OF THE APPARENT KOREAN REQUIREMENT THAT U.S. SHIPPING AND AIRLINE COMPANIES PAY THE DEFENSE TAX LEVIED AGAINST NET PROFIT. EMBOFF ASKED WHETHER DEFENSE TAX CAME WITHIN "THE INCOME TAX AND THE CORPORATION TAX" AS DEFINED IN PARAGRAPH 1(A), ARTICLE 8 OF THE DRAFT TAX CONVENTION. AFTER CONSULTATION WITH MINISTRY OF FINANCE AND PERHAPS OTHER MOFA OFFICIALS, LEE SAID THAT PRELIMINARY ROK RESPONSE WAS AS FOLLOWS:

A. THE LANGUAGE IN ARTICLE 10 OF THE DRAFT CONVENTION PROVIDES THAT "INCOME" WHICH DERIVES FROM THE OPERATION OF INTERNATIONAL TRAFFIC OF SHIPS OR AIRCRAFT SHALL BE EXEMPT FROM TAX. THE WORK "INCOME" ENCOMPASSES THE DEFENSE TAX LEVIED AGAINST

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NET PROFIT. THEREFORE, NO CHANGE IN THE DRAFT CONVENTION IS NECESSARY TO ENSURE THAT SHIPPING AND AIR TRANSPORT INCOME IS EXEMPT FROM THE DEFENSE TAX LEVIED AGAINST NET PROFIT.

B. U.S. CORPORATIONS WITH INCOME FROM SOURCES OTHER THAN SHIPPING AND AIR TRANSPORT MAY BE SUBJECT UNDER THE CONVENTION TO THE DEFENSE TAX LEVIED AGAINST NET INCOME, SINCE THE TAX HAS ALREADY BEEN IMPOSED. PARAGRAPH 2, ARTICLE 1, DOES NOT HELP, SINCE IT APPLIES ONLY TO NEW TAXES IMPOSED AFTER THE DATE OF SIGNATURE. HOWEVER, THE MINISTRY OF FINANCE INFORMALLY WILL ATTEMPT TO INTERPRET ARTICLE I SO AS TO INCLUDE THE DEFENSE TAX. LEE SUGGESTED BILATERAL U.S. ROK CONSULTATIONS AFTER THE SIGNING TO SETTLE THE APPLICABILITY OF THE DEFENSE TAX TO U.S. CORPORATIONS WITH INCOME FROM SOURCES OTHER THAN SHIPPING AND CIVIL TRANSPORT.

3. EMBOFF IS ADVISING MOF TAX OFFICIALS OF THE PROBABILITY THAT THE IRS WOULD TAKE THE VIEW THAT U.S. EXEMPTION OF INCOME KOREAN SHIPPING AND AIR TRANSPORT COMPANIES WOULD NO LONGER BE ALLOWED IF SIMILAR U.S. COMPANIES ARE SUBJECT TO THE DEFENSE TAX.

4. NORTHWEST AND FLYING TIGER, THE ONLY U.S. AIRLINES WITH SCHEDULED SERVICE TO KOREA, UNDERSTAND ON THE ADVICE OF THE SAME CONSULTANT (ARTHUR YOUNG COMPANY) THAT THEY ARE OBLIGED TO PAY THE DEFENSE TAX AND THEY HAVE PAID OR WILL PAY BY THE FILING DEADLINE, WHICH IS FEBRUARY 28. JAPAN AIRLINES ADVISES US THAT IT IS NOT REQUIRED TO PAY AND IS NOT PAYING THE DEFENSE TAX BECAUSE IT IS EXEMPTED UNDER THE BILATERAL KOREA-JAPAN TAX CONVENTION AND BILATERAL AIR AGREEMENT IN FORCE. ALL JAPANESE SHIPPING FIRMS WITH SCHEDULED SERVICE TO KOREA USE KOREAN AGENTS WHICH MUST PAY AND ARE PAYING THE DEFENSE TAX.
SNEIDER

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